



*Programming Errors and Deficiencies in
Tax Examiner Screening Resulted in
Some Health Coverage Tax Credit
Claims Being Erroneously Processed*

May 23, 2018

Reference Number: 2018-40-035

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information

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HIGHLIGHTS

PROGRAMMING ERRORS AND DEFICIENCIES IN TAX EXAMINER SCREENING RESULTED IN SOME HEALTH COVERAGE TAX CREDIT CLAIMS BEING ERRONEOUSLY PROCESSED

Highlights

Final Report issued on May 23, 2018

Highlights of Reference Number: 2018-40-035 to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

The Health Coverage Tax Credit (HCTC) is a refundable tax credit that covers 72.5 percent of the cost of qualified health insurance premiums for eligible individuals and qualified family members. Individuals can claim the HCTC in three ways: annually on their tax return, as advance monthly payments, or a combination of these two methods.

WHY TIGTA DID THE AUDIT

TIGTA initiated this audit because our prior report on the IRS's 2016 Filing Season identified errors in processing tax returns that claimed the HCTC. The overall objective of this review was to evaluate the IRS's implementation of the HCTC advance payment process and accuracy of processing tax returns claiming the credit.

WHAT TIGTA FOUND

Our review identified that the IRS implemented processes and procedures in response to legislation retroactively extending the HCTC through Calendar Year 2019. This includes implementing processes to set eligibility indicators on individual's tax accounts and establishing a systemic advance monthly payment process. However, programming and tax examiner errors continue to result in the erroneous processing of some HCTC claims.

Our review identified that 3,839 (9.5 percent) of the 40,227 Tax Year 2016 tax returns with HCTC claims filed between January 21 and July 6, 2017, were erroneously processed. Because of these errors, taxpayers potentially

did not receive HCTCs to which they were entitled or were erroneously allowed HCTCs to which they were not entitled. For example, 2,972 returns with HCTC claims totaling \$4,362,924 were not referred by tax examiners to the Examination function for review despite meeting Examination function referral criteria.

In addition, consistent screening processes are needed to identify erroneous HCTC claims. The Error Resolution Unit's screening process is not consistent with the process used by the Examination function to identify erroneous claims. As a result, HCTC claims totaling \$951,648 on 343 tax returns were erroneously paid to ineligible taxpayers. Finally, TIGTA identified that the IRS paid HCTC claims totaling \$128,807 on 45 returns filed by individuals who included Form W-2, *Wage and Tax Statement*, which indicates that they were employed.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) ensure that tax examiners follow procedures to refer potentially erroneous HCTC claims to the Examination function; 2) review 2,222 tax returns for which tax examiners erroneously disallowed the claim without first corresponding with the taxpayer; 3) confirm that programming changes are implemented to refer, to the Examination function, all returns filed by taxpayers who do not provide support for their HCTC; 4) review 664 returns for which tax examiners erroneously input the HCTC in computers; 5) develop procedures to identify tax examiner errors related to processing HCTC claims; 6) implement procedures to identify HCTC claims on returns filed by potentially ineligible individuals; 7) review the 343 returns for which an ineligible individual's HCTC claim was granted; and 8) refer the 45 returns that claimed the HCTC and had an attached Form W-2 to the Examination function.

The IRS agreed with all of the recommendations and stated that it plans to review the identified returns, update its procedures as needed, implement programming changes, and refer returns found to have had erroneously issued HCTCs to its Examination function for consideration and appropriate recovery actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

May 23, 2018

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Programming Errors and Deficiencies in Tax Examiner Screening Resulted in Some Health Coverage Tax Credit Claims Being Erroneously Processed (Audit # 201740034)

This report presents the results of our review to evaluate the Internal Revenue Service's implementation of the Health Coverage Tax Credit (HCTC) advance payment process and accuracy of processing tax returns claiming the credit. This audit was included in our Fiscal Year 2017 discretionary audit coverage and addresses the major management challenge of Implementing the Affordable Care Act and Other Tax Law Changes.

Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services).



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Abbreviations

DOL	Department of Labor
HCTC	Health Coverage Tax Credit
IRS	Internal Revenue Service
PBGC	Pension Benefit Guaranty Corporation
TAA	Trade Adjustment Assistance



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Background

The *Trade Adjustment Assistance Reform Act of 2002*¹ originally established the Health Coverage Tax Credit (HCTC) to help certain displaced workers and retirees pay for health insurance. The HCTC expired at the end of Calendar Year 2013. However, the *Trade Preferences Extension Act of 2015* (Trade Act)² retroactively extended and modified the HCTC through Calendar Year 2019. Taxpayers eligible to claim the credit fall into one of two categories:

- Trade Adjustment Assistance (TAA), alternate TAA, and reemployment TAA recipients. These individuals lost their jobs due to foreign imports or a production shift to certain foreign countries or as a result of trade-related layoffs. They are eligible for the HCTC if they meet certain criteria. Examples include being age 50 or older and earning \$50,000 or less in any new jobs obtained.
- Pension Benefit Guaranty Corporation (PBGC) benefits recipients. These are individuals who receive a PBGC pension benefit because their employer's pension plan was terminated and taken over by the PBGC when their former employer went bankrupt or experienced other severe financial difficulties.

The HCTC is a refundable tax credit³ that covers 72.5 percent of the cost of qualified health insurance premiums for eligible individuals and qualified family members.⁴ Individuals can claim the HCTC in three ways:

- **Annually** – Individuals claim the credit on their tax return by preparing and including Form 8885, *Health Coverage Tax Credit*.
- **Advance Monthly Payment** – The Trade Act required the Internal Revenue Service (IRS) to provide HCTC advance monthly payments. To enroll, individuals complete and mail Form 13441-A, *HCTC Monthly Registration and Update*, along with required supporting health plan documents to the IRS. The IRS will verify the individual's eligibility to participate in the program by confirming eligibility via the PBGC monthly eligibility updates and Department of Labor (DOL) daily updates. Once enrolled, the

¹ Pub. L. No. 107-210.

² H.R. 1295, Pub. L. No. 114-27. Enacted June 29, 2015.

³ Refundable tax credit means the taxpayer can receive a refund even if he or she did not owe taxes or earn income.

⁴ A qualified family member is the spouse, or former spouse in the event of a divorce, or a dependent of the PBGC payee or TAA recipient who is enrolled in a qualified health insurance plan. A PBGC payee or TAA recipient may continue to receive the HCTC for the coverage of qualified family members for up to 24 months after enrolling in Medicare. In addition, a qualified family member is eligible to receive the HCTC for up to 24 months following the death of or divorce from a PBGC payee or TAA recipient.



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IRS will mail the individual a letter stating that they are certified for the advance monthly payment program and explain their monthly payment responsibility.

Once registration is complete, individuals pay 27.5 percent of their health insurance premiums, in advance, to the HCTC program through the U.S. Bank Lockbox system by the 10th day of each month. The HCTC program then adds the Government's 72.5 percent advance portion of the insurance premium and sends the full payment to the individual's Health Plan Administrator each month.

- **Combination** – Individuals can claim the credit on their tax return for a portion of the year and also receive the benefit of the advance monthly payments for the remaining portion of the year.

The IRS partners with Federal and State agencies to administer the HCTC

The IRS administers the HCTC in partnership with other Federal and State agencies. The State workforce agencies, through the DOL and PBGC, are responsible for identifying individuals who are potentially eligible to receive the HCTC. The DOL and the PBGC each provide the IRS with lists of potentially eligible individuals. The DOL provides the information to the IRS on a daily basis, while the PBGC provides the eligibility lists monthly. On an annual basis, both the DOL and PBGC provide an eligibility list. The IRS uses these end-of-year lists to determine if individuals are eligible to claim the HCTC on their tax return. For individuals included on the lists, the IRS places an HCTC eligibility indicator on their tax account to verify HCTC claims during tax return processing.

Claiming the HCTC

To claim the HCTC, individuals file Form 8885 with their tax return. They elect the HCTC by checking a box on this form for each month they were eligible to claim the HCTC. Eligible individuals who pay more than 50 percent of their health insurance premiums can claim the HCTC when they file their Federal income tax return. However, individuals who received the benefit of advance monthly payments must exclude from Form 8885 any advance HCTC payments that the Government made on their behalf during the calendar year. Individuals are also required to attach documentation to support their eligibility for the credit. The documentation must include:

- An official letter from the DOL or PBGC indicating that the individual was eligible for the months claimed.
- Proof of enrollment in a qualified health insurance plan.
- Proof that the individual paid the insurance premiums.

The taxpayer inputs the HCTC amount shown on Form 8885 to Line 73 on Form 1040, *U.S. Individual Income Tax Return*. During tax return processing, all Forms 1040 with an amount on



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Line 73 are identified and routed to tax examiners in the IRS's Error Resolution Unit⁵ for review. Tax examiners verify the individuals' eligibility for the HCTC and proof of payment. If the IRS cannot verify eligibility for a specific claim, a tax examiner will correspond with the taxpayer. If the taxpayer responds that he or she is not eligible for the HCTC, tax examiners will disallow the claim. If, after corresponding with the taxpayer, the tax examiner still cannot verify the individual's eligibility for the credit, the tax return is released for processing and the IRS's Dependent Database⁶ filters are used to identify claims above a specified dollar amount. The potentially erroneous claims are sent to the IRS's Examination function within the Return Integrity and Compliance Services organization for review. For HCTC claims identified as potentially erroneous but with a claim amount below the Examination function referral amount, the IRS will allow the HCTC.

This review was performed in the HCTC Program Office at the IRS campus in Austin, Texas, during the period March 2017 through February 2018. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁵ The Error Resolution Unit provides for the correction of errors associated with input submissions.

⁶ A risk-based audit selection tool used to identify tax returns for audit. This tool includes information databases with birth certificate information and court documents used to establish a relationship and residency between a taxpayer and the qualifying children claimed on a tax return.



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Results of Review

Our review identified that the IRS implemented processes and procedures in response to legislation retroactively extending the HCTC through Calendar Year 2019. This includes processes to set eligibility indicators on individuals' tax accounts and establishing a systemic advance monthly payment process. For example:

- For Tax Year 2016,⁷ a total of 934,341 individuals were listed on the HCTC eligibility lists that the IRS received from the DOL and PBGC. Our review determined that indicators were set on 922,558 (99 percent) of the individuals' tax accounts. The vast majority of the individuals who did not have an eligibility indicator set on their tax account did not have an active tax account.
- In January 2017, the IRS implemented a systemic advance monthly payment process that includes processes and procedures to ensure that only eligible taxpayers receive advance HCTC payments. Our review determined that, of the 2,139 individuals enrolled in the advance payment program between January and August 2017, all were eligible to participate. *****1*****. We also determined that all individuals who paid their portion of the health insurance premiums had the remaining portion paid by the Government.

Some Health Coverage Tax Credit Claims Were Erroneously Processed

Our review identified that 3,839 (9.5 percent) of the 40,227 Tax Year 2016 tax returns with HCTC claims filed between January 21 and July 6, 2017,⁸ were erroneously processed. These errors resulted in taxpayers potentially not receiving HCTCs to which they were entitled or in HCTCs being erroneously granted to taxpayers who were not entitled to the credits. Erroneously processed returns include:

- 2,972 (7.4 percent) tax returns with HCTC claims totaling \$4,362,924 that were not referred by tax examiners to the Examination function, as required, despite meeting Examination function referral criteria. HCTC processing errors include:

⁷ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

⁸ The returns included 38,822 electronic and 1,405 paper returns, filed as of July 6, 2017, with HCTC claims totaling more than \$53 million.



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- 2,175 tax returns with HCTC claims totaling \$2,479,933 for which tax examiners erroneously disallowed the claim. Internal guidelines state that tax examiners can disallow HCTC claims if there is evidence that the credit was claimed for insurance sponsored by the taxpayer's employer or if the taxpayer responds to IRS correspondence that he or she is not eligible for the HCTC. None of the 2,175 tax returns met these criteria.
- 750 tax returns with HCTC claims totaling \$1,637,832 were erroneously allowed by tax examiners despite that the taxpayers did not have an eligibility indicator on their tax account and did not provide the required eligibility documentation. Internal guidelines state that if, in response to tax examiner correspondence, the taxpayer cannot provide proof of eligibility, tax returns with HCTC claims above a specified dollar amount are to be referred to the Examination function. IRS management stated that due to computer programming errors, these returns were not referred to the Examination function. In response to our identification of these returns, IRS management issued a directive to open examinations on the 750 tax returns.
- 47 tax returns with HCTC claims totaling \$245,159 filed by taxpayers who claimed both the Premium Tax Credit and the HCTC on their return, but their claims were not referred to the Examination function by tax examiners as required. Internal guidelines state that the Error Resolution Unit tax examiner is to place a hold on the credit and refer the refund tax return to the Examination function if the tax return:
1) includes both Form 8962, *Premium Tax Credit*, and Form 8885 for the same months; 2) the taxpayer has an HCTC eligibility indicator on the account; and 3) the HCTC claimed is above a specified dollar amount.
- 664 (1.7 percent) tax returns with HCTC claims totaling \$1,213,916 for which tax examiners erroneously input the HCTC claim in IRS computers. These include:
 - 344 tax returns with HCTC claims totaling \$470,421 for which tax examiners incorrectly transcribed the HCTC onto another line on the tax return when entering the information in IRS computers. As a result, these returns were not subjected to HCTC screening filters designed to identify potentially erroneous claims. We previously reported⁹ this same concern as it related to the processing of HCTC claims in the 2016 Filing Season.¹⁰ In response, the IRS reviewed the HCTC claims we identified as incorrectly processed to ensure that taxpayers received the HCTCs to which they were entitled and that erroneously issued HCTCs were recovered.
 - 320 tax returns with HCTC claims totaling \$743,495 for which tax examiners incorrectly transcribed another credit on Line 73 of the Form 1040 as an HCTC when

⁹ Treasury Inspector General for Tax Administration, Ref. No. 2017-40-014, *Results of the 2016 Filing Season* (Jan. 2017).

¹⁰ The period from January through mid-April when most individual income tax returns are filed.



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entering the information in IRS computers. As a result, these returns were subjected to HCTC screening filters even though the taxpayer did not claim the HCTC. These taxpayers received an IRS letter asking for support for a tax credit that they did not claim on their tax return.

- 203 (0.5 percent)¹¹ tax returns with HCTC claims totaling \$737,215 for which the taxpayer incorrectly used employer-sponsored health insurance premiums, reported on Form W-2, *Wage and Tax Statement*, to support the HCTC claim. Employer-sponsored health insurance does not qualify for the HCTC. For all 203 returns, the IRS has the authority to deny the HCTC claim based on this error and should have done so. Management reviewed a sample of these returns and agreed that they were processed in error. Of the 203 returns, we determined that 22 taxpayers with HCTC claims totaling \$39,802 erroneously received the credit. For the remaining 181 tax returns with HCTC claims (totaling \$697,413), the HCTC claims were allowed and are either under review by the Examination function or were reversed after the claims were processed.

Overall, in response to our providing the above erroneously processed HCTC claims, IRS management stated that tax examiners commit errors while processing the claims because the HCTC is infrequently claimed, requires extra handling, and can be more complex than other refundable credits.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Ensure that returns with HCTC claims meeting Examination function criteria are referred to the Examination function as required.

Management's Response: The IRS agreed with this recommendation and plans to update its procedures to clarify when referrals to the Examination function are to be made. IRS management also plans to centralize the assignments of HCTC work within the Error Resolution function to more experienced tax examiners.

Recommendation 2: Review the 2,222 tax returns we identified (for which tax examiners erroneously disallowed the claim without first corresponding with the taxpayer to obtain missing eligibility or payment documentation) to ensure that taxpayers received the HCTCs to which they were entitled and that erroneously issued HCTCs are recovered.

Management's Response: The IRS agreed with this recommendation and plans to review the identified returns to ensure that taxpayers received the HCTCs to which they were entitled. IRS management also plans to refer returns that had erroneously issued HCTCs to its Examination function for consideration and appropriate recovery actions.

¹¹ Percentages do not add to 100 percent due to rounding differences.



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Recommendation 3: Confirm that Dependent Database programming fixes were implemented and are working as intended to refer to the Examination function all tax returns filed by taxpayers who do not provide support for their eligibility to claim the HCTC.

Management's Response: The IRS agreed with this recommendation. IRS management responded that the Dependent Database programming corrections were implemented on February 21, 2017, and are performing as expected.

Recommendation 4: Review the 664 tax returns we identified (for which the Error Resolution Units erroneously input the HCTC claim in IRS computers) to ensure that taxpayers received the tax credits to which they were entitled and that erroneously issued tax credits are recovered.

Management's Response: The IRS agreed with this recommendation and plans to review the identified returns to ensure that taxpayers received the HCTCs to which they were entitled. IRS management also plans to refer returns found to have had erroneously issued HCTCs to its Examination function for consideration and appropriate recovery actions.

Recommendation 5: Develop a process and procedures to identify tax examiner errors related to processing HCTC claims (similar to the analysis performed in this audit) to ensure that taxpayers receive the HCTCs to which they are entitled and that erroneously paid HCTCs are recovered.

Management's Response: The IRS agreed with this recommendation and plans to evaluate where controls can be improved to identify errors associated with processing HCTC claims. IRS management will also update its procedures as needed and centralize the assignment of HCTC work within the Error Resolution function to more experienced tax examiners.

Recommendation 6: Review the 22 tax returns we identified for which the taxpayer incorrectly used employer-sponsored health insurance premiums, reported on Form W-2, to support an HCTC claim. Identify erroneously issued HCTCs and take actions to recover the credit.

Management's Response: The IRS agreed with this recommendation and plans to review the identified returns to ensure that taxpayers received the HCTCs to which they were entitled. IRS management also plans to refer returns found to have had erroneously issued HCTCs to its Examination function for consideration and appropriate recovery actions.



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**Consistent Screening Processes for Tax Examiners Are Needed to
Identify Erroneous Health Coverage Tax Credit Claims**

Our review of the 40,227 tax returns with HCTC claims processed between January 21 and July 6, 2017, identified that the Error Resolution Unit tax examiner screening process is not consistent with those used by the Examination function to identify erroneous claims. As a result, HCTC claims totaling \$951,648 on 343 tax returns were erroneously paid to ineligible taxpayers. The 343 returns include:

- 210 tax returns with HCTC claims totaling \$429,262 that involved individuals claiming the HCTC who were ineligible because they were 67 years of age or older as of January 1, 2016.¹² Individuals age 65 or over are eligible for Medicare and, thus, ineligible for the HCTC. In a prior report,¹³ we recommended that the IRS develop procedures to ensure that individuals meet HCTC eligibility qualifications, including age, before adding eligibility indicators to tax accounts. The IRS agreed with our recommendation and planned to request computer programming changes that will perform the requisite automated checks to ensure that taxpayers who do not meet eligibility requirements do not receive an eligibility indicator on their tax account. As of February 22, 2018, the IRS had not completed this programming change. It should be noted that until the programming change is in place, management would have to simply update their internal guidelines to require tax examiners to verify the age of the taxpayer to identify ineligible individuals claiming the credit.
- 111 tax returns with HCTC claims totaling \$378,307 for which the taxpayer reported a self-employed health insurance deduction that was either equal to the HCTC amount on the taxpayer's Form 8885 or 27.5 percent of the HCTC amount (within \$10). The 27.5 percent is the net amount of health insurance premiums an individual pays when claiming the HCTC. On 95 of the 111 returns, the taxpayer claimed a self-employed health insurance deduction for 100 percent of the HCTC claimed on his or her Form 8885. IRS procedures state that the HCTC cannot be claimed to offset costs associated with self-employed health insurance. Management stated that they will request guidance from the Wage and Investment Division's Counsel Office on whether tax examiners have the authority to deny these HCTC claims.
- 12 tax returns for which taxpayers received advance HCTC payments totaling \$99,038, but they did not reduce the HCTC amount they claimed on Form 8885 by the advance

¹² Since a taxpayer is eligible to receive the HCTC for coverage for qualified family members for up to 24 months from the month he or she turns 65, we identified only instances in which an individual aged 67 or over received the HCTC.

¹³ Treasury Inspector General for Tax Administration, Ref. No. 2017-40-033, *Implementation of the Health Coverage Tax Credit Enrollment and Systemic Advance Monthly Payment Process* (May 2017).



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payments received. Taxpayers who received advance HCTC payments are required to exclude these payments from their HCTC amount claimed.

- 10 returns with HCTC claims totaling \$45,041 for which the deduction for medical and dental expenses reported on Schedule A, *Itemized Deductions*, was equal to the HCTC amount reported on Form 8885 (within \$10). IRS procedures state that the HCTC cannot be related to medical and dental expenses reported on Schedule A. Management will request guidance from the Wage and Investment Division's Counsel Office on whether tax examiners have the authority to deny these HCTC claims.

In response to the 210 tax returns that involved individuals claiming the HCTC who were ineligible because of their age, the IRS stated that it is in the process of updating tax examiner procedures to screen all HCTC claims to identify individuals who are 67 years of age or older and refer these tax returns to the Examination function. When discussing the remaining results with management, they noted that the volume of tax returns claiming the HCTC did not warrant updating tax examiner screening procedures. Management's position is inconsistent with the screening processes already in place when potentially erroneous claims are sent to the Examination function. These Examination screening processes would identify the above types of erroneous claims. In addition, preventing erroneous claims totaling \$951,648 in our opinion warrants updating of tax examiner screening procedures.

Review of Forms W-2 attached to returns claiming the HCTC could further identify erroneous claims

Our review identified HCTC claims totaling \$128,807 on 45 returns filed by individuals who included Form W-2 with their tax return, which indicates that they obtained a job during the calendar year. The Form W-2 for each individual reported earnings of more than \$50,000, which, as previously stated in this report, exceeds the amount an individual may earn in the calendar year and still be eligible for the HCTC. When we provided the 45 erroneous HCTC claims to IRS management, they stated that our review did not consider the timing of when the individual became eligible for the HCTC and when the individual obtained the new job. We agree that our review did not consider all eligibility criteria. However, management did not implement a screening process to consider these criteria and make a determination as to whether the individual was eligible.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 7: Implement Error Resolution Unit screening procedures to identify HCTC claims on tax returns filed by potentially ineligible individuals. These procedures should include screening processes to identify individuals who are 67 years of age or older.



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Management's Response: The IRS agreed with this recommendation and has implemented systemic improvements that identify accounts that are not eligible for the HCTC and prevents the eligibility indicator from being applied to them. IRS management also plans to continue evaluating performance and updating its procedures, as necessary. Additionally, IRS management believes centralizing HCTC work within the Error Resolution function to ensure that it is assigned to more experienced tax examiners will yield improvements in the screening process.

Recommendation 8: Implement Error Resolution Unit screening procedures to identify individuals who 1) claimed a self-employed health insurance deduction equal to 27.5 or 100 percent of the HCTC amount and 2) claimed medical and dental expenses on Schedule A equal to 27.5 or 100 percent of the HCTC amount.

Management's Response: The IRS agreed with this recommendation and plans to update and revise its procedures to recognize and identify cases for which it appears the HCTC is used to offset costs associated with self-employed health insurance or deducted as a medical expense on Schedule A. IRS management also plans to centralize the assignment of HCTC work within the Error Resolution function to more experienced tax examiners.

Recommendation 9: Implement Error Resolution Unit screening procedures to identify individuals who received advance HCTC payments and claimed the full amount of HCTC on their tax return.

Management's Response: The IRS agreed with this recommendation. IRS management responded that the condition of individuals who claim the HCTC on their tax returns and received advance payments must be addressed by deficiency procedures. For Tax Year 2017 returns, a list of subject returns will be provided to the Examination function for audit consideration. For subsequent periods, the Dependent Database will be used to identify these returns and evaluate them for compliance treatment. Addressing returns subsequent to Tax Year 2017 returns will require programming, which is subject to limited resources and competing priorities.

Recommendation 10: Implement Error Resolution Unit screening procedures to identify individuals who filed a Form W-2, indicating that they obtained a new job.

Management's Response: The IRS agreed with this recommendation and plans to update its procedures to require the appropriate research to identify when a HCTC claimant obtained employment.

Recommendation 11: Review the 343 tax returns we identified (for which an ineligible individual's HCTC claim was granted) to ensure that taxpayers received the HCTCs to which they were entitled and that erroneously issued HCTCs are recovered.



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Management's Response: The IRS agreed with this recommendation and plans to review the identified returns to ensure that taxpayers received the HCTCs to which they were entitled. IRS management also plans to refer returns found to have had erroneously issued HCTCs to its Examination function for consideration and appropriate recovery actions.

Recommendation 12: Review the 45 tax returns that claimed the HCTC and had an attached Form W-2 to ensure that taxpayers received the HCTCs to which they were entitled and that erroneously issued HCTCs are recovered.

Management's Response: The IRS agreed with this recommendation and plans to review the identified returns to ensure that taxpayers received the HCTCs to which they were entitled. IRS management also plans to refer returns found to have had erroneously issued HCTCs to its Examination function for consideration and appropriate recovery actions.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the IRS's implementation of the HCTC advance payment process and accuracy of processing tax returns claiming the credit. To accomplish this objective, we:

- I. Assessed controls to ensure that only eligible taxpayers had the HCTC indicator on their Tax Year 2016 tax accounts.¹
 - A. Obtained the lists of individuals potentially eligible for the HCTC from the PBGC and DOL and compared them to the list of individuals that the IRS identified with the HCTC eligibility indicator.
- II. Evaluated controls to ensure that only eligible individuals obtain HCTC advance monthly payments.
 - A. Obtained the list of individuals receiving advance HCTC payments from the IRS for payments made from January 2017 to August 2017 and determined if the individuals receiving advance monthly HCTC payments had a characteristic indicating that they were ineligible for the credit. These characteristics included individuals who were 67 years of age or older, deceased, or imprisoned.
 - B. Compared the list of advance payments received by the U.S. Bank Lockbox system to the Department of the Treasury's list of payments and verified that everyone who made their 27.5 percent advance payments had the remaining balance paid by the Government.
- III. Assessed IRS controls to ensure that only eligible HCTC claims were allowed on Tax Year 2016 returns.
 - A. Identified the list of individuals who claimed the HCTC on Tax Year 2016 Forms 8885, *Health Coverage Tax Credit*, filed during the 2017 Filing Season² and determined the status of the credits. We identified the number of credits held by the IRS, the number of credits reversed, and the number of credits for which the taxpayer received the benefit of the credit.

¹ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

² The period from January through mid-April when most individual income tax returns are filed.



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- B. Determined if the individuals receiving the benefit of the HCTC claimed on Form 8885 had any characteristics that would make them ineligible for the credit.
- C. Identified all active business rules that relate to the HCTC's core criteria that would cause a return to reject to the transmitter/taxpayer.
- D. Identified the population of Forms 8885 processed by the Error Resolution Unit for which the HCTC was allowed and determined if each case was worked correctly.
- E. Identified the population of Forms 8885 processed by the Error Resolution Unit for which the HCTC was disallowed or held to prevent it from refunding and determined if each case was worked correctly.

Data validation methodology

During this review, we relied on the HCTC advance monthly payment information provided to us by the IRS and validated the payment data by comparing them to reports produced by the IRS's Integrated Financial System.³ We also obtained data from the IRS's Individual Master File,⁴ Individual Return Transaction File,⁵ and National Account Profile⁶ that were available on the Treasury Inspector General for Tax Administration's Data Center Warehouse.⁷ Before relying on the data, we selected random samples of each extract and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System.⁸ We also obtained electronically filed Form 8885 and Individual Master File data from the Treasury Inspector General for Tax Administration Office of Audit's Information Services team. We also selected a random sample of this extract and verified that the data were the same as the data captured in the IRS's Integrated Data Retrieval System. Based on the results of our testing, we believe that the data used in our review were reliable.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems

³ The Integrated Financial System contains the IRS's core financial systems, including expenditure controls, accounts payable, accounts receivable, general ledger, and budget formulation.

⁴ The Individual Master File is an IRS database that maintains transactions or records of individual tax accounts.

⁵ The Individual Return Transaction File contains data transcribed from initial input of the original individual tax returns during tax return processing.

⁶ The National Account Profile contains IRS and Social Security Administration information for date of birth and date of death for each Taxpayer Identification Number.

⁷ The Data Center Warehouse is a collection of IRS databases containing various types of taxpayer account information that is maintained by the Treasury Inspector General for Tax Administration for the purpose of analyzing data for ongoing audits.

⁸ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: processes to ensure that only eligible taxpayers have the HCTC eligibility indicator on their tax accounts; controls to ensure that only eligible individuals obtain HCTC advance monthly payments; and controls to ensure that only eligible HCTC claims are allowed on tax returns. We tested these controls by comparing the PBGC and DOL eligibility lists to those tax accounts with an HCTC eligibility indicator and determining whether only eligible individuals received advance monthly HCTC payments and HCTCs claimed on their Tax Year 2016 tax returns.



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Appendix II

Major Contributors to This Report

Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services)

Allen Gray, Director

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Appendix III

Report Distribution List

Deputy Commissioner for Services and Enforcement
Commissioner, Wage and Investment Division
Director, Submission Processing, Wage and Investment Division
Director, Office of Audit Coordination



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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

Revenue Protection – Potential; 366 tax returns with HCTC claims totaling \$510,223 (see page 4).

Methodology Used to Measure the Reported Benefit:

Our review of 40,227 Tax Year¹ 2016 paper and electronically filed tax returns with HCTC claims filed between January 21 and July 6, 2017, identified 366 tax returns for which IRS processing errors resulted in taxpayers receiving \$510,223 in HCTCs to which they potentially were not entitled. These errors include:

- 344 tax returns with HCTC claims totaling \$470,421 for which tax examiners incorrectly transcribed the HCTC onto another line on the tax return when entering the information in IRS computers. As a result, these returns were not subjected to HCTC screening filters designed to identify potentially erroneous claims.
- 22 tax returns with HCTC claims totaling \$39,802 for which the taxpayer incorrectly used the employer-paid health insurance amount, reported on Form W-2, *Wage and Tax Statement*, to support the HCTC claim.

Type and Value of Outcome Measure:

Taxpayer Burden – Potential; 320 tax returns for which processing errors caused taxpayers to inappropriately receive an IRS letter requesting support for a tax credit they did not claim (see page 4).

Methodology Used to Measure the Reported Benefit:

Our review of 40,227 Tax Year 2016 paper and electronically filed tax returns with HCTC claims filed between January 21 and July 6, 2017, identified 320 tax returns for which tax examiners incorrectly transcribed another credit on Line 73 of the Form 1040, *U.S. Individual*

¹ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.



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Income Tax Return, as an HCTC when entering the information in IRS computers. As a result, these returns were subjected to HCTC screening filters even though the taxpayer did not claim the HCTC. These taxpayers experienced the burden of receiving an IRS letter asking for support for a tax credit that they did not claim on their tax return.

Type and Value of Outcome Measure:

Revenue Protection – Potential; 222 tax returns with HCTC claims totaling \$528,300 (see page 8).

Methodology Used to Measure the Reported Benefit:

Our review of the 40,227 tax returns with HCTC claims processed between January 21 and July 6, 2017, identified 222 tax returns for which the inconsistency between the Error Resolution Unit and Examination function screening processes resulted in taxpayers receiving \$528,300 in HCTCs to which they potentially were not entitled. The 222 returns include:

- 210 tax returns with HCTC claims totaling \$429,262 that involved individuals claiming the HCTC who were ineligible because they were 67 years of age or older as of January 1, 2016. Individuals age 65 or over are eligible for Medicare and, thus, ineligible for the HCTC.
- 12 tax returns for which taxpayers received advance HCTC payments totaling \$99,038, but they did not reduce the HCTC amount they claimed on Form 8885, *Health Coverage Tax Credit*, by the advance payments received. Taxpayers who received advance HCTC payments are required to exclude these payments from the HCTC amount claimed on their tax returns.



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Appendix V

Management's Response to the Draft Report




COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

April 17, 2018

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kenneth C. Corbin 
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Programming Errors and Deficiencies in Tax
Examiner Screening Resulted in Some Health Coverage Tax
Credit Claims Being Erroneously Processed (Audit # 201740034)

Thank you for the opportunity to review and provide comments on the subject draft report. The Trade Preferences Act of 2015 retroactively extended and modified the Health Coverage Tax Credit (HCTC) through December 31, 2019. Taxpayers eligible to claim the credit may fall into one of two categories: Trade Adjustment Assistance (TAA), alternative and reemployment TAA recipients; and Pension Benefit Guaranty Corporation (PBGC) benefits recipients. Individuals may claim the HCTC in three ways: annually, by claiming the credit on Form 8885, *Health Coverage Tax Credit* and attaching it to their tax return; through the advance monthly payment program; or by a combination of claiming the credit on their tax return for a portion of the year and receiving the benefit of the advance monthly payments for the remainder of the year.

For the 2016 tax year, approximately \$47.1 million was issued to 27,500 HCTC-eligible individuals and \$27.1 million of advance monthly payments were disbursed on behalf of 1,910 eligible individuals to 104 HCTC vendors. The IRS administers the HCTC in partnership with other federal and state agencies. State workforce agencies, through the Department of Labor (DOL) and the PBGC, are responsible for identifying individuals who are potentially eligible to receive the HCTC. The DOL and the PBGC each provide the IRS with lists of potentially eligible individuals. The annual year-end lists provided to us are used to place eligibility indicators on the accounts of identified individuals. This assists us in determining program eligibility when processing tax returns claiming the HCTC. The eligibility indicators are also used in systemically processing advance monthly payments to qualifying recipients. Systemic improvements have been made to ensure that ineligible recipients, such as those over the age of 67 years, prisoners, and persons without active tax accounts do not receive the advance payments. Further, we corrected programming to ensure all tax returns filed by



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taxpayers who do not provide support for their eligibility to claim the HCTC are referred to the examination function for appropriate treatment.

As noted in the report, some HCTC claims were incorrectly processed or were not referred by Tax Examiners to the Examination function for review. We believe the primary cause of errors made by Tax Examiners while processing HCTC claims is attributable to the low frequency of HCTC claims, the complexity of the credit, and the extra handling required in comparison to other refundable credits. To improve the processing of HCTC claims, we will update the procedural instructions for Tax Examiners, and will centralize the processing of HCTC claims within our Error Resolution function so that more experienced Tax Examiners are addressing this work. We believe those actions will significantly reduce the number of erroneously processed HCTC claims.

In conjunction with improving procedures for processing HCTC claims, we continue to deploy the HCTC Compliance Strategy for HCTC claims filed on original and amended returns. Claims will be denied if taxpayers are not identified as eligible and/or have not met the filing requirements. In Fiscal Year 2017, we initiated and closed examinations of 11,125 claims where taxpayers did not establish eligibility. Through the end of September 2017, our compliance efforts have protected \$37.3 million in unsubstantiated HCTC claims.

Attached are our comments and proposed actions to your recommendations. If you have any questions, please contact me, or a member of your staff may contact James P. Clifford, Director, Customer Account Services, Wage and Investment Division, at 470-639-3504.

Attachment



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Attachment

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1

Ensure that returns with HCTC claims meeting Examination function criteria are referred to the Examination function as required.

CORRECTIVE ACTION

We agree with this recommendation. The procedural instructions contained in the Internal Revenue Manual (IRM) will be updated to clarify when referrals to the Examination function are to be made. We will also centralize the assignment of Health Coverage Tax Credit (HCTC) work within the Error Resolution function to more experienced Tax Examiners.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 2

Review the 2,222 tax returns we identified (for which tax examiners erroneously disallowed the claim without first corresponding with the taxpayer to obtain missing eligibility or payment documentation) to ensure that taxpayers received the HCTCs to which they were entitled and that erroneously issued HCTCs are recovered.

CORRECTIVE ACTION

We agree with this recommendation and will review the identified returns to ensure that taxpayers received the HCTCs to which they were entitled. Returns found to have had erroneously issued HCTCs will be referred to our Examination function for consideration and appropriate recovery action.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division



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CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 3

Confirm that Dependent Database programming fixes were implemented and are working as intended to refer to the Examination function all tax returns filed by taxpayers who do not provide support for their eligibility to claim the HCTC.

CORRECTIVE ACTION

We agree with this recommendation. The Dependent Database (DDb) programming corrections were implemented on February 21, 2017, and have been found to be performing as expected.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

Director, Refundable Credits Policy and Program Management, Return Integrity and Compliance Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 4

Review the 664 tax returns we identified (for which the Error Resolution Units erroneously input the HCTC claim in IRS computers) to ensure that taxpayers received the tax credits to which they were entitled and that erroneously issued tax credits are recovered.

CORRECTIVE ACTION

We agree with this recommendation and will review the identified returns to ensure that taxpayers received the HCTCs to which they were entitled. Returns found to have had erroneously issued HCTCs will be referred to our Examination function for consideration and appropriate recovery action.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division



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CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 5

Develop process and procedures to identify tax examiner errors related to processing HCTC claims (similar to the analysis performed in this audit) to ensure that taxpayers receive the HCTCs to which they are entitled and that erroneously paid HCTCs are recovered.

CORRECTIVE ACTION

We agree with this recommendation and will evaluate where controls can be improved to identify errors associated with processing HCTC claims. The instructions contained in the IRM will be updated as needed. We will also centralize the assignment of HCTC work within the Error Resolution function to more experienced Tax Examiners.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 6

Review the 22 tax returns we identified for which the taxpayer incorrectly used the employer-sponsored health insurance premiums, reported on Form W-2, to support the HCTC claim. Identify erroneously issued HCTCs and take actions to recover the credit.

CORRECTIVE ACTION

We agree with this recommendation and will review the identified returns to ensure that taxpayers received the HCTCs to which they were entitled. Returns found to have had erroneously issued HCTCs will be referred to our Examination function for consideration and appropriate recovery action.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL



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Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 7

Implement Error Resolution Unit screening procedures to identify HCTC claims on tax returns filed by potentially ineligible individuals. These procedures should include screening processes to identify individuals who are 67 years of age or older.

CORRECTIVE ACTION

We agree with this recommendation. Systemic improvements have been implemented that identify accounts that are not eligible for the HCTC and prevents the eligibility indicator from being applied to them. We will continue to evaluate performance and will update procedural instructions in the IRM, as necessary, to improve and clarify screening procedures. Additionally, centralizing HCTC work within the Error Resolution function so that it is assigned to more experienced Tax Examiners is expected to yield improvements in the screening process.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 8

Implement Error Resolution Unit screening procedures to identify individuals who 1) claimed a self-employed health insurance deduction equal to 27.5 or 100 percent of the HCTC amount and 2) claimed medical and dental expenses on Schedule A equal to 27.5 or 100 percent of the HCTC amount.

CORRECTIVE ACTION

We agree with this recommendation and will update and revise procedures accordingly to recognize and identify cases where it appears the HCTC is being used to offset costs associated with self-employed health insurance or is being deducted as a medical expense on Schedule A, *Itemized Deductions*. Instructions in the IRM will be updated,



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as necessary, and this work will be centralized within the Error Resolution function so that it is assigned to more experienced Tax Examiners.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 9

Implement Error Resolution Unit screening procedures to identify individuals who received advance HCTC payments and claimed the full amount of HCTC on their tax return.

CORRECTIVE ACTION

We agree with this recommendation; however, addressing the condition of individuals who claim the HCTC on their tax returns and received advance payments must be addressed by deficiency procedures. For Tax Year 2017 returns, a list of subject returns will be provided to the Examination function for audit consideration. For subsequent periods, the DDb will be used to identify these returns and evaluate them for compliance treatment. Addressing post-2017 returns will require programming, which is subject to limited resources and competing priorities. We expect this work to be completed by January 2019; however, due to limited resources and competing priorities, we cannot provide an implementation date.

IMPLEMENTATION DATE

July 15, 2018 – Provision of Tax Year 2017 returns list to the Examination function.
N/A – Programming the DDb to identify and refer post-2017 returns.

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.



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RECOMMENDATION 10

Implement Error Resolution Unit screening procedures to identify individuals who filed a Form W-2, indicating that they obtained a new job.

CORRECTIVE ACTION

We agree with this recommendation and will update the IRM to require the appropriate research to determine when a HCTC claimant had obtained employment.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 11

Review the 343 tax returns we identified (for which an ineligible individual's HCTC claim was granted) to ensure that taxpayers received the HCTCs to which they were entitled and that erroneously issued HCTCs are recovered.

CORRECTIVE ACTION

We agree with this recommendation and will review the identified returns to ensure that taxpayers received the HCTCs to which they were entitled. Returns found to have had erroneously issued HCTCs will be referred to our Examination function for consideration and appropriate recovery action.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.



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RECOMMENDATION 12

Review the 45 tax returns that claimed the HCTC and had an attached Form W-2 to ensure that taxpayers received the HCTCs to which they were entitled and that erroneously issued HCTCs are recovered.

CORRECTIVE ACTION

We agree with this recommendation and will review the identified returns to ensure that taxpayers received the HCTCs to which they were entitled. Returns found to have had erroneously issued HCTCs will be referred to our Examination function for consideration and appropriate recovery action.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.